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C O N F I D E N T I A L SARAJEVO 001066

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TAGS: ECON PGOV BK
SUBJECT: BOSNIA: THE VIEW FROM THE RS PRIVATIZATION AGENCY

REF: SARAJEVO

Classified By: AMBASSADOR DOUGLAS L. MCELHHANEY FOR REASON 1.4(B).

¶1. (C) Summary: New legislation to review past RS privatizations (reftel) has shone the spotlight on the RS Directorate for Privatization (DfP). However, the intense focus on process misses the broader point: Many entity-owned companies are little more than a pile of liabilities by time they are transferred to the DfP -- the result of asset stripping, embezzlement and incompetence by corrupt government managers. A review of the data shows that the DfP has done a respectable job of selling entity-owned companies, many of which are technically insolvent, thereby unloading significant liabilities that would otherwise be the responsibility of the RS government. Without the DfP's "creative packaging," most of these companies have no option other than bankruptcy. The real lesson of an objective privatization review is that the government should get out of the business sector as fast as possible. End Summary.

The DfP's Response

¶2. (C) RS Prime Minister Milorad Dodik, decrying "sweetheart deals", has made a revision of past privatizations a cornerstone of his pre-election economic policy (reftel). DfP Director Vladimir Makcic, who has headed the agency for less than two years, has responded to these claims with a spirited defense of the agency's performance during his tenure. Makcic has provided the Embassy with detailed data on the DfP's activities to support his claims. It should also be noted that, while the DfP does the technical work, the RS government has ultimate responsibility for privatization and must approve all deals before they are finalized.

¶3. (C) According to data from Makcic, small-scale privatization (defined as companies with entity-owned capital of less than KM 300,000) has largely been completed. The agency first attempted to sell these companies through competitive public tender. If the tenders failed to attract a minimum number of bidders, the DfP engaged in direct negotiations with any interested buyer. The results of Makcic's energetic work speak for themselves: After years with very little activity, the DfP had successfully privatized 54 small companies (out of a total of 182 in its portfolio) by June 2005. There was no interest in the remaining companies, most of which are insolvent. The DfP does not have the authority to initiate bankruptcy

procedures, so many of these firms remain in limbo -- piling up wage, pension, tax and other liabilities that will eventually have to be unwound.

¶4. (C) There has been a similar acceleration in so-called "strategic" privatizations (a term that is applied very loosely in the RS). In the seven years before Mackic arrived, the DfP sold a total of eight strategic enterprises. Since his arrival, the DfP has successfully sold nine companies.

The Numbers Speak for Themselves

¶5. (C) Banjalucka Brewery (BLB) is the largest strategic privatization to date. The company was sold for KM 23 million in December, 2005. This is less than the KM 25.6 million book value of RS government shares in the company. However, it is significantly higher than the KM 18.1 million appraisal of actual market value. The buyers pledged to invest a minimum of KM 7.8 million in the firm and retain current employment levels for three years. The new owners of BLB, an Anglo-American private equity firm, also assumed KM 40 million in liabilities.

¶6. (C) This was the third attempt to privatize the brewery. The first tender was canceled in the wake of a public uproar after the government decided to sell BLB to a Slovenian firm whose offer was significantly lower than other bidders. Major international brewers such as Annheiser Busch and Interbrew expressed initial interest in the second privatization auction two years ago, which was conducted far more professionally. However, it too failed after they pulled out following the collapse of BLB's margins and profits -- the result of brewery management's inability to handle increased competition from cheap imported beer, principally from Serbia. By the time the third tender was conducted, BLB was hemorrhaging cash and operating at less than 17% capacity.

¶7. (C) Other strategic privatizations tell a similar story. The DfP sold UNIS, a cold rolled steel facility, for KM 2.1 million. Although the value of the company's assets was estimated at KM 4.8 million, the firm had been out of business since 1992 and had liabilities of more than KM 702,000. The DfP privatized a dairy for KM 500,000, against assets valued at KM 1.7 million. However, the buyers assumed KM 7.9 million in liabilities. Oslobodenje, a printer, was sold for the symbolic price of KM 100. For this princely sum, the buyers got state capital appraised at KM -2.6 million and liabilities of KM 8.5 million.

Comment

¶8. (C) The current review of past privatizations diverts attention from the real issue -- the RS government's poor track record in managing what should be private business. Entity-owned companies are milked for all they're worth and slated for sale when there's nothing left on the books but liabilities. Given the quality of its portfolio, the DfP has done an admirable job of rapidly selling off companies that are worth less with every passing day. If there is an operative lesson to be learned from the ongoing review, it is that the RS government should get out of the business sector as quickly as possible. The DfP should be given additional flexibility to entice bidders to buy RS-owned companies. The longer the RS government maintains direct control over business activity, the more it will end up having to pay for wage and pension liabilities that continue to accrue each day in insolvent entity-owned companies. End Comment.
KAIDANOW